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IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1974

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No. 74-825

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MERCY N. CLINCHER, ET AL,

Petitioners.

v.

THE UNITED STATES AND THE STATES OF ARIZONA AND MONTANA,

Respondents.

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# RESPONDENT ARIZONA'S REPLY BRIEF TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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# I N D E X


| | Page |
|---|---|
| QUESTION PRESENTED | 2 |
| STATUTES INVOLVED | 2 |
| STATEMENT OF THE CASE | 11 |
| REASONS WHY THIS WRIT SHOULD BE DENIED | 14 |
| 1. Petitioners Do Not Have A Cause of Action Against the United States For Amounts Withheld As State Income Taxes | 14 |
| 2. Court of Claims Decision Not in Conflict With Acts of Congress and Other Decisions of United States Courts | 23 |
| CONCLUSION | 26 |

## CITATIONS


| Cases: | Page |
|---|---|
| Aetna Casualty & Surety Co. v. Port of New York Authority 182 F.Supp. 671 (S.D.N.Y. 1960) | 19 |
| American Fidelity Co. v. Delaney 114 F.Supp. 702 (D.C. Vt. 1953) | 18 |
| Grasso v. Oehmann 54 A.2d 570 (D.C. Mun.Ct.App. 1947) | 18 |
| McClanahan v. Arizona State Tax Commission 411 U.S. 164 (1973) | 4 |
| United States v. Crossland Construction Co. 217 F.2d 275 (1954) | 18 |

Statutes:

Arizona Revised Statutes:

| | |
|---|---|
| § 43-188 | 4,20,22 |
| § 43-188(f) | 4 |
| § 43-188(g) | 9 |
| § 43-188(h) | 11 |
| § 43-188(i) | 11 |

Statutes--Continued Page

United States Code:

4 U.S.C. §§ 105-110 25,26

5 U.S.C. § 5517 2,11,12,14,20, 21,22,23,24,26

5 U.S.C. § 5517(b) 21,22

Rules:

Rule 19, Rules of Supreme Court 23

Legislative Materials:

Senate Report 1309, U.S. Code Cong. Admin. News, p. 2360 (82d Cong. 2d Sess., 1952) 16

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The Respondent State of Arizona replies to the Petitioners' Writ of Certiorari to review the judgment of the United States Court of Claims in this case.

## QUESTION PRESENTED

Whether the United States is liable for amounts it withheld from the wages of federal employees for state income taxes which the United States paid to the states where the employees are American Indians and the incomes were earned from employment within the boundaries of Indian Reservations located within the boundaries of the taxing states.

## STATUTES INVOLVED

The Withholding Act, Act of July 17, 1952, ch. 940, 66 Stat. 765, as amended by the Act of September 6, 1966, ch. 55, 80 Stat. 478-79 (5 U.S.C. § 5517), provides:

> "§ 5517. Withholding State income taxes
>
> "(a) When a State statute --
>
> "(1) provides for the collection of a tax by imposing on employers generally the duty of withholding sums from the pay of employees and making returns of the sums to the State; and

"(2) imposes the duty to withhold generally with respect to the pay of employees who are residents of the State;

the Secretary of the Treasury, under regulations prescribed by the President, shall enter into an agreement with the State within 120 days of a request for agreement from the proper State official. The agreement shall provide that the head of each agency of the United States comply with the requirements of the State withholding statute in the case of employees of the agency who are subject to the tax and whose regular place of Federal employment is within the State with which the agreement is made. The agreement may not apply to pay for service as a member of the armed forces.

"(b) This section does not give the consent of the United States to the application of a statute which imposes more burdensome requirements on the United States than on other employers, or which subjects the United States or its employees to a penalty or liability because of this section. An agency of the United States may not accept pay from a State for services performed in withholding State income taxes from the pay of the employees of the agency.

"(c) For the purpose of this section, 'State' means a State or territory or possession of the United States."

A.R.S. § 43-188 (f), (g), (h) and (i) as in effect prior to 1973 amendments read as follows:

"43-188. COLLECTION OF TAX - INFORMATION AT SOURCE: WITHHOLDING TAX

. . . .

(f) WITHHOLDING TAX

(1) On and after January 1, 1970, every employer at the time of the payment of wages, salary, bonus or other emolument to any employee whose compensation is for services performed within this state shall deduct and retain therefrom an amount equal to ten per cent of the total amount of the federal income tax deducted and withheld by an employer from the total value of such wages, bonus or other emolument of an employee under the provisions of the internal revenue code of the United States computed without deductions for any amount withheld, and shall, quarterly, on or before the last day of April, July, October, and January of each year, pay over to the commission the amount so collected during the preceding calendar quarter. For the purposes of this section the term 'employer' means the person for whom an individual performs or performed any service, of whatever

nature, as the employee of such person including any officer or department of the state or any political subdivision or agency of the state, or any city organized under a charter, or any political body not a subdivision or agency of the state, except that if the person for whom the individual performs or performed the services does not have control of the payment of the wages for such services, the term 'employer' means the person having control of the payment of such wages.

(2) The amounts deducted from the wages of an employee during any calendar year in accordance with the provisions of this subsection shall be considered to be paid in part payment of the tax on such employee's taxable income for his tax year which begins within such calendar year, and the return made by the employer pursuant to paragraph (5) may be accepted by the commission as prima facie evidence of the amounts so deducted from his wages.

(3) No amount shall be deducted or retained from:

(A) Wages paid for active service in the military or naval forces of the United States.

(B) Wages or salary paid to an employee of a common carrier when such employee is a nonresident of

Arizona as defined in section 43-101 and regularly performs services both within and without the state of Arizona.

(C) Wages paid for domestic service in a private home.

(D) Wages paid for casual labor not in the course of the employer's trade or business.

(E) Wages paid to part-time or seasonal employees whose services to the employer consist solely of labor in connection with the planting, cultivating, harvesting or field packing of seasonal agricultural crops, except such employees whose principal duties are operating any mechanically driven device in such operations.

(4) In the case of nonresident employees who are residents of another state of the United States or the District of Columbia and are allowed a tax credit for income taxes paid to their state of residency or domicile under the provisions of section 43-128(b)(1) sufficient in amount to offset the tax required by this section to be withheld from the wages of an employee, the tax commission may by rules and regulations relieve the employers of such employees from withholding requirements of this section with respect to such employees.

(5) When the total amount deducted under this subsection exceeds the amount of the tax on the employee's entire taxable income as computed under this title, the commission shall, after auditing the annual return filed by the employee in accordance with section 43-142, and without requiring a filing of a refund claim as provided in section 43-184(b)(1), refund the amount of the excess deducted, without interest thereon. Failure of the commission to make such refund shall not limit the right of the taxpayer to file a claim for a refund as provided in section 43-184. No refund shall be made to an employee who fails to file such return within one year from the due date of the return in respect of which the tax withheld might have been credited. If the excess tax deducted is less than one dollar, no refund shall be made unless specifically requested by the taxpayer at the time such return is filed. In no event shall any excess be allowed as a credit against any tax accruing on a return filed for a year subsequent to the year during which such excess was withheld, the provisions of section 43-184 notwithstanding.

The commission may make separate refunds of withheld taxes upon request by a husband or wife who has filed a joint return, the refund payable to each spouse being proportioned to the gross earnings of

each shown by the information returns filed by the employer or otherwise shown to the satisfaction of the commission. If a taxpayer entitled to a refund under this subsection dies, the commission may certify to the commissioner of finance that the refund be made to the taxpayer's executor, administrator, or duly appointed representative.

(6) Every employer shall, with each payment made by him to the commission, deliver to the commission a return in the form prescribed by the commission, showing the total amount of wages, salaries, bonuses or other emoluments paid to his employees, the amount deducted therefrom in accordance with the provisions of this subsection, and such other information as the commission may require. The employer is charged with the duty of advising the employee of the amount of moneys withheld, in accordance with such regulations as the commission may prescribe, using printed forms furnished by the commission for such purposes, or when requested by the employer upon forms approved by the commission.

The employer shall make an annual return for the calendar year to the commission on forms provided by it, summarizing the total compensation paid and the tax withheld for each

employee during the calendar year and shall file the same with the commission before February 16 of the year following the year for which the report is made. The return required in the preceding sentence shall contain or be verified by a written declaration that it is made under the penalties of perjury, and the information contained in said return shall satisfy the requirements of section 43-188(b) relating to the salaries and wages included in the report required under this paragraph.

The employer shall, within thirty days after the end of each calendar year, furnish such employee with either a statement of the amount withheld during the previous tax year, showing the gross earnings and the amount of tax withheld, or, if the termination of employment is prior to the end of the year, then, within fifteen days after the termination of employment, a summary statement showing the total earnings for the tax year and the amount of taxes withheld from compensation.

(g) LIABILITY FOR FAILURE TO WITHHOLD; PENALTY FOR FAILURE TO REMIT

(1) The employer shall be liable to the tax commission for the payment of the tax required to be deducted and withheld under this section, and the employee shall not thereafter be liable for the amount of any such payment, nor shall the

employer be liable to any person or any employee for the amount of any such payment. For the purpose of making penalty sections of this title applicable, any amount deducted or required to be deducted and remitted to the commission under this section shall be considered the tax of the employer and with respect to such amounts he shall be considered as a taxpayer.

(2) Whenever any employer is required to collect or withhold the tax imposed by this title from any employee and to pay such tax over to the tax commission, the amount of tax so collected or withheld shall be held to be a special fund in trust for the state of Arizona. The amount of such fund shall be assessed, collected, and paid in the same manner and subject to the same provisions and limitations (including penalties) as are applicable with respect to the taxes from which such fund arose.

(3) Any employer intrusted with, or having in his control any tax required to be collected or withheld and constituting a 'special fund in trust for the state of Arizona' pursuant to this subsection, who fraudulently appropriates, or secrets with a fraudulent intent to appropriate, to any use or purpose not in the due and lawful execution of the trust, pursuant to this section, any portion thereof, shall be guilty of

embezzlement under section 13-682, and shall be punishable as provided in sections 13-688 and 13-689.

(h) WITHHOLDING AGENT, MUST PAY WITHOUT RESORTING TO ACTION. Any person required to withhold and transmit any amount pursuant to this section shall comply with the requirement without resort to any legal or equitable action in a court of law or equity.

(i) WITHHOLDING TAX, REFUND THEREFOR. Any taxpayer from whom a tax is collected by withholding under this title is entitled to the remedies set forth in sections 43-163(b), 43-175(1), 43-184 to 43-186 and 43-195(c) except where such sections are in conflict with this section."

## STATEMENT OF THE CASE

Each of the Petitioners is an Indian resident of an Indian Reservation on which he was employed by the United States. Pursuant to the provisions of the Withholding Act of 1952, 5 U.S.C. § 5517, authorizing the withholding of State income taxes from the wages of Federal employees, statutes of Montana

and Arizona imposing a duty of withholding on employers generally, and agreements with those States providing for such withholding, the United States withheld State income taxes from the wages of these Federal employees and paid such withheld sums to the States of Arizona and Montana. Six of the Petitioners were residents of, and employed on Indian Reservations in Montana and one of the Petitioners was a resident of and employed on an Indian Reservation in the State of Arizona.

The Petitioners sued the United States to recover the amounts withheld and paid over to Arizona and Montana. The Petitioners also sued on behalf of all other American Indians similarly situated to recover amounts withheld from their wages under 5 U.S.C. § 5517 and State statutes authorizing withholding

and agreements entered into pursuant thereto.

The United States interpleaded as third party defendants, the States of Montana and Arizona. The Petitioners and the United States each moved for summary judgment with the United States also praying that any judgment against it be made a judgment against the States of Montana and Arizona. Montana and Arizona moved to dismiss on the grounds of failure to state a claim upon which relief can be granted or alternatively on the ground of lack of jurisdiction. The United States Court of Claims granted the motions of the United States and the States and dismissed the case on the grounds that Petitioners did not have a claim for which relief could be granted. The Petitioners moved for rehearing. The Court issued an order denying the motion for rehearing and changing two sentences in its opinion.

REASONS WHY THIS WRIT SHOULD BE DENIED.

1. Petitioners Do Not Have a Cause Of Action Against the United States For Amounts Withheld As State Income Taxes.

The Petitioners claim in this case is based on its construction of 5 U.S.C. § 5517, the statute regulating the withholding of state income taxes of United States Government employees. The particular language of the statute which the Petitioners rely on as is indicated by the emphasis in the quotation of the statute on page 3 of their Petition is "in the case of employees of the agency who are subject to the tax." In considering its meaning, that phrase should not be isolated from the remaining language of the statute, but rather it should be read in para materia with the other provisions of this statute. The statute also

provides "this section does not give the consent of the United States to the application of a statute which imposes more burdensome requirements on the United States than on other employers . . . ."

Another provision of that statute to be reconciled with the language the Petitioners rely on is "This section does not give the consent of the United States to the application of a statute . . . which subjects the United States or its employees to a penalty or a liability because of this section." From that language it is apparent that Congress foresaw the possibility of becoming involved in State tax disputes through the withholding of State income taxes and that language was utilized to avoid that result. The Petitioners'

position does not give any effect to this statutory language which was designed to avoid United States involvement in state tax disputes.

In Senate Report 1309, U.S. Code Cong. Admin. News, p.2360 (82d Cong., 2d Sess., 1952), the Report of the Senate Committee states that the Government shall comply with the requirements of State income tax withholding statutes with respect to employees subject to the tax and immediately after that the following sentence appears in the Report: "The bill further provides that nothing in the Act shall be deemed to consent to the application to the United States of any provision of any statute which has the effect of subjecting the United States to any liability." Thus, avoidance of liability for claims of wrongful withholding was an overriding requirement and there is

therefore no inconsistency between the language that the Petitioners rely on and the language of the remainder of the statute. This statute does not indicate whether remedies of the employee would include an action to enjoin the United States from the collection of the tax or an action against the state for the refund of the taxes, but it most certainly indicates that one remedy the Petitioners do not have is an action against the United States for wrongful withholding of state income taxes where a State has a statute providing for such withholding.

This construction of the statute is certainly confirmed by the decisions of the courts relating to United States income tax withholding statutes. When an employer withholds tax from an employee's wages and pays him the balance,

the employee has been paid in full and the employer then has the tax liability. The employer alone is then liable to the United States for the tax collected. United States v. Crossland Construction Co., 217 F.2d 275 (1954); American Fidelity Co. v. Delaney, 114 F.Supp. 702 (D.C., Vt. 1953).

Where tax withheld by an employer was not paid over to the United States, it was held that the employee had no right to bring an action against the employer for return of the tax. The employee was entitled to a credit on his tax for any amounts withheld even though such amounts were not paid over to the Government. Grasso v. Oehmann, 54 A.2d 570 (D.C.Mun.Ct.App. 1947).

Another case indicating that the employee does not have a cause of action against the United States for income

taxes "wrongfully withheld" is Aetna Casualty & Surety Co. v. Port of New York Authority, 182 F.Supp. 671 (S.D.N.Y. 1960). In that case the employer failed to remit amounts withheld from wages of employees for Federal income taxes. The Court held that under those circumstances the employees did not have a claim for the amounts withheld and that the Government did not have a claim against the surety on a performance bond of the defaulting contractor that the contract was breached by a failure to pay wages because of the construction contractor's failure to remit the amount deducted for withholding taxes. The Court noted that this argument of wrongful failure to pay wages has been repeatedly rejected in other cases.

Although the cases establishing this theory have arisen in connection with the performance of Government contracts, there is no valid reason why the same statutory language should have one meaning for purposes of Government contracts and an entirely different meaning for purposes of State income tax claims. In these cases the Court has reasoned that the employer was the agent of the Government for the purposes of collecting the tax and payment of the tax to the agent or withholding by the agent constituted payment of the tax to the Government discharging the employee of liability for the tax. Applying that reasoning to this analagous situation, when the United States withholds State income taxes under 5 U.S.C. § 5517 and State statutes such as A.R.S. § 43-188 which are patterned after the

Internal Revenue Code withholding provisions, the United States is the agent of the State for the purpose of collecting that tax. Withholding by the United States therefore constitutes payment of the tax by the employee. Any remedy of the employee in regard to refund of the amount withheld under 5 U.S.C. § 5517 is against the taxing authority rather than against the employer who is merely the agent of the taxing authority.

When Congress provided in 5 U.S.C. § 5517(b): "This section does not give the consent of the United States to the application of a statute . . . which subjects the United States or its employees to a penalty or liability because of this section" that is literally what Congress intended. It was the desire of Congress to cooperate with the States in enacting 5 U.S.C. § 5517, but Congress

but did not want to assume the obligation of indemnifying its employees to the extent of any loss incurred by them because of unconstitutional action on the part of State tax administrators. Congress simply did not want the United States to become involved through 5 U.S.C. § 5517 in disputes between its employees and State taxing authorities.

The decision of the Court of C'aims is consistent with the language of 5 U.S.C. § 5517(b) which expressly prohibits this cause of action; with the language of Arizona Revised Statutes, § 43-188, the provisions of the Internal Revenue Code after which that section is patterned and the case law construing those provisions of the Internal Revenue Code. Employers are not compensated for withholding State or Federal income taxes. To saddle these employers with the risk

of liability because of disputes between taxpayers and taxing authorities would unduly increase their uncompensated burdens under the withholding statutes and thus multiply the problems of compliance with the withholding laws upon which so much of the state and federal revenues depend. Accordingly, the provisions of 5 U.S.C. § 5517 prohibiting this type of action should not be construed into a nullity.

2. Court of Claims Decision Not In Conflict With Acts of Congress And Other Deicisions of United States Courts.

Under Rule 19 of the Rules of the Supreme Court, certiorari is granted only where there are special and important reasons, such as a conflict of a decision with other decisions or statutes. Here no such conflict has been demonstrated. The decision of the Court of Claims is

perfectly consistent with the relevant Acts of Congress and other decisions of United States courts and it relates only to an event that will not recur.

The Petitioners contend that the Court of Claims decision undercuts a decision of this Court in McClanahan v. Arizona State Tax Commission, 411 U.S. 164 (1973). The Court of Claims decision does not have that effect because of very substantial differences between the two cases. In this case there is an adequate remedy in the state courts whereas there was none in the McClanahan case. The issue in this case is the construction of 5 U.S.C. § 5517 rather than the question of whether Indians are liable for State taxes. The sole purpose of the suit in the United States Court of Claims was to circumvent State statutes of limitation. Since the Petitioners have

an adequate remedy in the State courts and the only purpose of the suit in the Court of Claims was to circumvent the State statutes of limitation, the Court of Claims decision is not in conflict with Federal congressional policies concerning freedom of reservation Indians from State obligations or with congressional policy of preferential employment.

The Petitioners contend that the decision of the Court of Claims ignores the Buck Act. The Buck Act, 4 U.S.C. §105 - § 110 is not applicable to this case. Under the Buck Act, the State tax law remained unchanged as to Indians. That is the purpose of Section 109 of the Buck Act which provides:

> "Nothing in Sections 105 and 106 of this title shall be deemed to authorize the levy or collection of any tax on or from any Indian not otherwise taxed."

There is a profound difference between a statute such as the Buck Act which in substance provides that the tax status of Indians is to remain unchanged and a statute which would carve out an exception to the provision of 5 U.S.C. § 5517 that the United States does not give its consent to the application of a statute which subjects the United States to liability because of compliance with State withholding requirements.

## CONCLUSION

Since the decision of the Court of Claims is not in conflict with other decisions of the United States courts and since it is not in conflict with Acts of Congress, this writ should not be granted.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that on this 31st day of January, 1975, three copies of the RESPONDENT ARIZONA'S REPLY BRIEF TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS were air-mailed postage prepaid to Richard A. Baenen, Esq., 1735 New York Avenue, N.W., Washington, D.C. 20006, Attorney for Petitioners.

I further certify that all parties required to be served have been served.

BRUCE E. BABBITT
The Attorney General

James D. Winter

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State of Arizona

Subscribed and sworn to before me this 31st day of January, 1975.

Iris A. Harris (nee Roberts)
Notary Public

My Commission expires:
My Commission Expires Aug. 13, 1976